

SFC proposals to address analyst conflicts of interest

The public are being asked to comment on new SFC proposals to reduce and manage analyst conflicts of interest.

Our proposed guidelines cover eight important areas suggested by the International Organization of Securities Commissions. They are:

- analysts' trading and financial interests;
- firm's financial interests and business relationships;
- analysts' reporting lines and compensation;
- firms' compliance systems and senior management responsibility;
- outside influences;
- clarity, specificity and prominence of disclosure;
- integrity and ethical behaviour; and
- investor education.

In devising the proposals, we have considered the views of market participants

and the investing public, and also regulatory developments abroad. But we are keeping an open mind, and will consider any suggestions received. The consultation will end on 30 April. We aim to publish the consultation conclusions in the third quarter this year and implement the requirements by the end of the year.

The SFC believes the proposals will not stifle legitimate investment or sales ideas, or unnecessarily constrain the flow of information. Brokers' sales and dealing operations will also unlikely be affected.

The proposed guidelines aim to regulate SFC licensees only. They do not apply to non-SFC licensees including journalists and media organisations.

The Consultation Paper is available at the SFC office and on its website at: http://www.hksec.org.hk/eng/bills/html/consultation/acoi_mar04.htm.

Retail Investor Survey

The SFC conducted a Retail Investor Survey in late 2003 and published the results last month. The survey found that retail investors were discerning with respect to their investment decisions.

The survey found that Hong Kong stocks continued to be the most popular investment, with a 23.8% participation rate.

It found that 82.5% of stock investors did their own analysis on the fundamentals of a listed company before buying its stock. Over 42% of stock investors referred to celebrity analysts' comments and newspaper and television analyses.

When buying IPO shares, 36% of investors looked at the background and reputation of the new issuer, 27.5% based their decision on comments in the media and on financial information websites, and 23.4% relied on the prospectus.

The Survey report is available at the SFC office and on its website at: http://www.hksec.org.hk/eng/press_releases/html/surveys_reports/retail_investor_survey_040303_eng.pdf.

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Sir Howard Davies, Director of the London School of Economics and former Chairman of the UK Financial Services Authority (1997-2003), delivered a speech entitled "What's left for self-regulation?" at a roundtable luncheon jointly organised by the Hong Kong Association of Banks, Hong Kong Securities Institute and the SFC on 26 March 2004. The picture shows Sir Howard (left) receiving a souvenir from SFC Chairman Mr Andrew Sheng.



Senior management interview

Andrew Young, Chief Counsel

What is your role as Chief Counsel?

To adopt a football analogy, I play in many different positions, from coach through outfield player to referee. However, I suppose that the most crucial position is as goalkeeper, the SFC's last line of defence. It is my job to try to ensure that the SFC achieves its objectives within its powers under the Securities and Futures Ordinance (SFO) and other applicable laws.

What are your main responsibilities?

The Legal Services Division (LSD) performs four main functions – giving legal advice to the Commission on the SFO and other applicable laws, law drafting and promulgation, civil and criminal litigation, and policy work. The Division consists of 12 lawyers and four support staff. LSD is the smallest division but we work with all four operational divisions and other support units across the whole range of SFC activities.

Do you prosecute?

Yes, the Commission may prosecute offenders in the Magistrates' Court. LSD personnel do quite a bit of this ourselves though we have to brief out about one-third of the prosecution cases, usually the more complex ones, because of our limited in-house resources. Latterly, there has been an increasing trend of defendants pleading

not guilty, resulting in multi-day trials. It is possible that this trend is due to the more serious view taken by the Courts of securities-related offences and the heavier penalties that have been imposed recently.

Can you give an example of policy work?

We have recently published guidance on the process by which the Commission



consults the market. LSD co-ordinated the work on drafting the procedures and prepared this guidance in order to increase the Commission's transparency. We are currently involved in the legal policy and drafting aspects of the development of a scripless model for securities trading.

What is the biggest challenge this year?

One of the major challenges will be to draft legislative amendments to give statutory backing to part of the Listing Rules as the outcome of the Government's consultation on enhancement of the regulation of listing. We also need to ensure the continued smooth implementation of the SFO. As the SFC increases its effort against corporate misconduct, we also anticipate actions under section 214 of the SFO, which we may use to seek remedies in cases of unfair prejudice etc to interests of members of listed corporations.

Personal bio

- Joined SFC on 20 March 2000. Appointed Chief Counsel on 1 December 2001.
- Previously a Legal Counsellor with the UK Foreign and Commonwealth Office – posted to Hong Kong (1994 – 1997) as a seconded to Hong Kong Government to assist with the handover of sovereignty; member of Sino-British Joint Liaison Group from 1 July, 1997 until its sunset on 1 January 2000.
- LL.B., Queen's University, Belfast; LL.M. and Doctor of Civil Law, McGill University, Montreal; qualified as a solicitor in Northern Ireland (1988), England & Wales (1990) and Hong Kong (2002).
- Big-time Liverpool FC fan, enjoys movies, music, books and quiet time with family. Has travelled extensively to around 50 countries and Asia is the fourth continent on which he has lived.

SFC investigates unusual bids

The SFC is investigating certain trading activities that occurred during the pre-opening session before the listing debut of two companies last year. The investigation will determine whether market manipulation or other misconduct took place.

The SFC notes that unreasonably high bid orders for PICC Property and Casualty Company Limited and Great Wall Automobile Holding Company Limited were placed during the pre-opening sessions on 6 November 2003 and 15 December 2003 respectively. These bid orders were cancelled quickly. They had distorted the price discovery

process during the pre-opening sessions and misled the public to believe that the stocks would be traded at substantially higher prices.

We have issued warning letters to a number of brokers and licensed persons. Other cases are still being actively pursued. The SFC would like to remind all licensed persons that such trading practice is unacceptable.

For more details, please see press release issued on 12 February 2004, available on the SFC website at: <http://eapp01.hksec.org.hk/apps/cc/PressRelease.nsf/eng/1kupNewsCode/04PR27?openDocument>.

Roadmap for listing reform

The Government has announced its consultation conclusions on proposals to enhance the regulation of listing. The SFC welcomes the proposals.

The first phase of the reform includes giving statutory backing to listing requirements on financial reporting and other periodic disclosure, disclosure of price sensitive information, and shareholders' approval for notifiable transactions. In the second phase, the Government, the SFC and HKEx will review the extension of these statutory provisions to cover other listing requirements.

The Securities and Futures Ordinance (SFO) will be amended such that market misconduct will cover breaches of the

statutory listing rules. The amendments will be introduced into Legco in early 2005. Civil sanctions by the Market Misconduct Tribunal or criminal sanctions can be imposed on offenders.

The SFO will also be amended to empower the SFC to impose direct civil sanctions, namely reprimands and disqualification orders, on issuers, directors and corporate officers for breaches.

The SFC will be responsible for enforcing the statutory listing requirements and HKEx will continue to receive listing applications at the frontline.

The SFC will focus its work in the short term on the new legislative rules to be made by

it under the SFO. It also looks forward to developing with HKEx measures outlined in the conclusions paper to enhance further the transparency of listing regulation.

Meanwhile, HKEx and the SFC have agreed that the SFC would be the sole regulator of sponsors, SFC Chairman Mr Andrew Sheng said in a keynote speech at Asia Pacific In-House Counsel Summit last month. The consultation conclusions on the regulation of IPO sponsors and independent financial advisers will be published soon.

The consultation conclusions on regulation of listing are available on the website of Financial Services and the Treasury Bureau at www.info.gov.hk/fstb/fsb. Mr Sheng's speech is available on the SFC website at: http://www.hksfc.org.hk/eng/press_releases/html/speech/04/as_040324_asia_pacific_summit.pdf.

Be sensitive

The SFC issued a circular last month to advise analysts on the handling of non-public price sensitive information about listed company securities.

Following SFC's reprimand last year of an analyst who had selectively disclosed non-public price sensitive information, the SFC received enquiries from the industry on the

subject. The circular was issued to address these queries.

The circular gives guidance on the relevant laws, regulations and codes of conduct. It also elaborates on what constitutes "non-public information", "price sensitive information" and what analysts should do if they receive such information.

It is intended to complement the "Guide on Disclosure of Price Sensitive Information" issued by HKEx. The Guide advises listed companies on how to handle price sensitive information.

For more details, please see press release issued on 19 March 2004, available on the SFC website at: <http://eapp01.hksfc.org.hk/apps/cc/PressRelease.nsf/eng/1kupNewsCode/04PR53?openDocument>.



FAQs

Q: A listed company has declared its dividend. If I buy its shares a day after the "ex-dividend date" but before the "book close date" starts, will I receive the declared dividend?

A: No. "Book close date" is the period when a listed company suspends the updating of the Register of Shareholders. "Ex-dividend date" is two trading days before the book close date. *Investors must acquire the shares before the ex-dividend date in order to be eligible for receiving the dividend.* Conversely, investors will still be entitled to the dividend if they possess the shares until the ex-dividend date. The share price will be adjusted downwards on the ex-dividend date to reflect the impact of the dividend payout.

In brief

The **Securities and Futures Ordinance** commenced operation a year ago on 1 April 2003. Implementation has been successful. (<http://eapp01.hksfc.org.hk/apps/cc/PressRelease.nsf/eng/1kupNewsCode/04PR64?openDocument>)

The SFC **Shareholders Group** held its 18th meeting in March to discuss the Exposure of Draft Code on Corporate Governance Practices and Corporate Governance Report with HKEx representatives.

\$4 million surplus projected for 2004-05

The SFC has estimated a surplus of about \$4 million in the financial year 2004-05, after 10 years of deficit budget.

For the 12th successive year, the SFC has not asked for Government grant. In addition, the SFC has decided not to revise its fees and charges this year. It will tightly control its expenditure.

We aim to contain operating expenditure after depreciation at roughly the same level in 2003-04, with very moderate increase to put additional resources to areas that are considered necessary.

Approved estimates for the year 2004-05 (HK\$million)

Revenue	447.30
Operating Expenditure	416.37
Depreciation	27.00
Surplus	3.93
Projected reserves at beginning of the year	615.56
Reserves at end of the year	619.49
Capital expenditure	13.08

Revised estimates for 2003-04

Meanwhile, strong market turnover helped turn a projected deficit into a surplus for the financial year 2003-04.

The SFC had expected a deficit of \$93 million in its original approved estimates. As at the end of January, we recorded a surplus of \$97 million. The full year results will be published in May.

For more details, please see SFC's approved estimates for 2004-05 and press release issued on 1 March 2004, available on the SFC website at: <http://eapp01.hksfc.org.hk/apps/cc/PressRelease.nsf/eng/1kupNewsCode/04PR38?openDocument>.



Circulars

The following recently published circulars are available on the SFC website under "Bills, Legislation and Codes" - "Regulatory Handbook" - "Codes, Guidelines and Circulars" at: <http://eapp01.hksfc.org.hk/apps/CC/RegulatoryHandbook.nsf/GenerateHTMLTBEnglish?openAgent&1>.

1. Circular to Licensed Corporations and Associated Entities Anti-Money Laundering / Combating Terrorist Financing US President's Executive Order 13224 (01.04.2004)
2. Circular to Licensed Corporations which are Participants of Hong Kong Futures Exchange Limited - Licence Holders Insurance Scheme for the Year Commencing 1 April 2004 under the Securities and Futures (Insurance) Rules (29.03.2004)
3. Circular to Licensed Corporations which are Participants of the Stock Exchange of Hong Kong Limited - Licence Holders Insurance Scheme for the Year Commencing 1 April 2004 under the Securities and Futures (Insurance) Rules (29.03.2004)
4. Circular to Licensed Corporations and Associated Entities Anti-Money Laundering / Combating Terrorist Financing US President's Executive Order 13224 (26.03.2004)
5. Circular to analysts on handling non-public price sensitive information (19.3.2004)
6. Circular to Licensed Corporations and Associated Entities Anti-Money Laundering / Combating Terrorist Financing (1) Non-cooperative Countries and Territories (2) United Nations Sanctions (Afghanistan) Regulation (03.03.2004)
7. Circular to Licensed Corporations and Associated Entities Anti-Money Laundering / Combating Terrorist Financing (1) US President's Executive Order 13224 (2) United Nations (Anti-Terrorism Measures) Ordinance (27.02.2004)
8. Circular to licensed corporations which are Engaged in Asset Management and/or Giving Advice on Funds/Portfolios - Fund Management Activities Survey 2003 (26.02.2004)

Safer means for IPO cheques refund

Investors are now better protected against the theft of IPO refund cheques following the introduction of certain preventative measures.

The SFC, the Hong Kong Monetary Authority, the Commercial Crime Bureau, the Immigration Department and the Federation of Share Registrars discussed preventative measures earlier this year after receiving complaints from investors regarding missing refund cheques for unsuccessful IPO shares applications.

One of the measures is the use of plain, unmarked envelopes when share registrars send refund cheques through the post. Investors may also make requests to collect the refund cheques in person, or to receive them through registered mail. Further measures are under discussion.

For advice on IPO investment, please see an article on IPO subscription on page 6. Other education leaflets and articles are available on the SFC-operated Electronic Investor Resources Centre under "IPO Investing" at: http://www.hkeirc.org/mainpage/index_display.jsp?eng_chi=1&menu_id=2.

IPO process to be improved

The SFC has published a report on the allotment results announcement errors last December in the IPO of China Life Insurance Company Limited.

The report describes the events leading up to the discovery of the errors and how the incident was resolved. It also examines the nature and scope of the errors and how they occurred, identifies issues and explores the way forward, including making recommendations to improve the IPO process.

For more details, please see the report and press release issued on 8 April 2004, available on the SFC website at: <http://eapp01.hksfc.org.hk/apps/cc/PressRelease.nsf/eng/1kupNewsCode/04PR71?openDocument>.



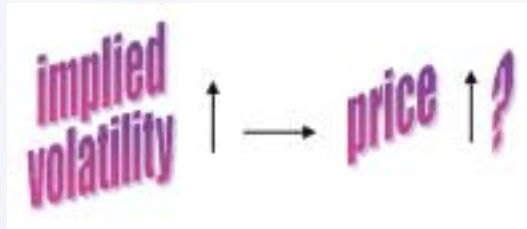
Investor focus

Valuation of derivative warrants

A warrant's valuation depends on a number of factors: the time to expiry, the price of the underlying asset and the "expected" volatility of that price, interest rate and dividend etc. Some of these factors relate to expectations in the future and can only be estimated.

Warrant issuers may have different views on the "expected" volatility when pricing a derivative warrant on the same underlying asset. To judge whether a derivative warrant is expensive or cheap, you should refer to its "implied volatility". *The higher the implied volatility, the more expensive a derivative warrant.* Some newspapers, information vendors and websites of warrant issuers provide latest figures of implied volatility for investors' references.

Take the example of a call warrant, its price will normally increase if the price of the underlying rises. However, the increase may be offset by changes in other factors such as volatility and consequently the increase may not be of the same magnitude as expected.



Investor Tips

- Don't mix up a plain vanilla warrant with an exotic one. The relationship between the price of an exotic warrant and the value of its underlying asset is far more complicated.
- There may be different structures of derivative warrants being offered on the same underlying asset. Pick the right one that best suits you.
- The market price of a derivative warrant is also subject to the market force of supply and demand. It is possible for the actual market price to diverge from its theoretical valuation.

For more details, please read an article *Choosing a Warrant under "Feature" – "Warrants" on the SFC-operated Electronic Investor Resources Centre* at: http://www.hkeirc.org/mainpage/index_display.jsp?eng_chi=1&menu_id=2.



Investor resources

The following items of investor resources have been made available to the investing public recently. They can be found on the SFC website or the Electronic Investor Resources Centre (eIRC) at the URLs provided.

Investor Alert Updates (<http://www.hksfc.org.hk/eng/investor/html/alert.htm>):

16 unlicensed overseas companies including "Citixpress Finance & Security Co. Ltd", "GCI Bank Corp", "Global Financial Standards Union" (07.04.2004), "Stuart Reed Kammer", "Wallace and Hampton, Inc" (29.03.2004), "Providence Group" (23.03.2004), "Douglas Baker & Co", "Innovative Consulting Inc" (22.03.2004), "Kobe Securities International" (17.03.2004), "Baker & White", "Capital Futures Limited", "Whitman Pearce & Partners" (15.03.2004), "Mason McHale Portfolio Management (Limited)" (09.03.2004), "Commonwealth Monetary Group", "European Private Equity Consultants" (08.03.2004) and "Global Capital Management" (23.02.2004), and two suspicious fraudulent websites of "www.jfunds.com" (15.03.2004) and "www.wsgroups.com/indexs.htm" (08.03.2004) have been added to the Alert List.

Dr Wise's Column (http://www.hksfc.org.hk/eng/investor/html/dr_wise.htm)

Dieting and Investing - it's the same discipline... (30.03.2004), and *Investing in an IPO* (24.02.2004)

Others:

The last episode of the SFC investor education radio drama series, *Talk on Wise Investing*, was broadcast on CR1 in mid-March. The whole series (in Cantonese only) is now available under "Studio" on the SFC-operated Electronic Investor Resources Centre at: http://www.hkeirc.org/mainpage/index_display.jsp?eng_chi=1&menu_id=5&second_menu_id=2.

In brief

The SFC has made **appointments** of new members and re-appointment of existing members of the following committees and panel: Academic and Accreditation Advisory Committee, Investor Education Advisory Committee, Dual Filing Advisory Group, Takeovers and Mergers Panel, Takeovers Appeal Committee and SFC (HKEC) Listing Committee. These committees and panel are set up under section 8 of the Securities and Futures Ordinance. (For more details, please see press releases issued on 2, 25 and 26 March 2004 available on the SFC website at: <http://eapp01.hksfc.org.hk/apps/cc/PressRelease.nsf/eng/HTMLGeneralNews?openAgent>.)

A new round of **Teachers' Workshop** has been so popular that we have doubled the number of sessions to 17. More than 1,400 enrolments were received for the original eight sessions to be held until the end of May. (http://www.hksfc.org.hk/eng/investor/html/teachers%20corner/schedule_mar_2004_revised.doc)

A new insurance broker has been appointed to arrange and administer the **fidelity insurance schemes** for exchange participants for the scheme year from 1 April 2004 to 31 March 2005. (<http://eapp01.hksfc.org.hk/apps/cc/PressRelease.nsf/eng/1kupNewsCode/04PR45?openDocument>)

Wisdom on IPO investing

Many retail investors have participated in recent IPOs. Dr Wise would like to remind you to study the company fundamentals of stocks, know your limits and not to commit beyond your means when investing.

Of 177 IPOs in 2002 and 2003, 76 might not have provided profits for first day traders – they closed without gains or the gains were probably not sufficient to cover interest expense and transaction costs.

Meanwhile, Dr Wise also finds that dieting and investing have a lot in common. One needs to set a goal and research to determine which products suit one's needs. He advises investors to review their investment portfolio on a regular basis, just like people who are on diet should monitor their health constantly.

Dr Wise is a fictitious character representing the collective wisdom and knowledge of market experts at the SFC. His column is published on the last Tuesday of every month. Please refer to articles Investing in an IPO and Dieting and Investing – it's the same discipline... which are available on the SFC website under "Advice to Investors" at: <http://www.hksfc.org.hk/eng/investor/html/dr.wise.htm>.

Other publications



The following publications have been published since the release of the last *SFC Alert*. They are available on the SFC website under "Press Releases, Publications & Speeches" - "Publications" at: http://www.hksfc.org.hk/eng/press_releases/html/publication.htm.

1. Enforcement Reporter (14.4.2004)
2. Report on Errors in Newspaper Announcements of Allotment Results of the Initial Public Offering of Shares in China Life Insurance Company Limited (08.04.2004)
3. Consultation Paper on the Regulatory Framework for Addressing Analyst Conflicts of Interest (31.03.2004)
4. Enforcement Reporter (09.03.2004)
5. Retail Investor Survey 2003 (03.03.2004)
6. Consultation Conclusions on the Securities and Futures (Contracts Limits and Reportable Positions)(Amendment) Rules 2003 and proposed amendments to the Guidance Note on Position Limits and Large Open Position Reporting Requirements (02.03.2004)
7. Report of the Securities and Futures Commission on the Recommendations made by the Working Group on Review of the Financial Regulatory Framework for Licensed Corporations (23.02.2004)
8. Quarterly Bulletin - Winter 2003 (19.02.2004)

Upcoming Events

- A souvenir presentation ceremony of the Smart Investor Awards will be held this month to award persons who have reported to the SFC financial scams that target Hong Kong investors. See more details in the next issue of *SFC Alert*.
- The SFC's *Annual Report 2003-2004* will be published in mid-May.

Note: There are no outstanding SFC staff recruitment advertisements.

Subscription information

The bi-monthly *SFC Alert* forms part of our range of regular publications; others include the monthly *SFC Enforcement Reporter*, the *Quarterly Report*, the *Quarterly Bulletin* and the *Annual Report*. All these publications are posted on the SFC website.

Free subscription to the electronic version of the *SFC Alert* (and other publications) can be made to sfcalert@hksfc.org.hk.

Feedback

Tell us what you think of the *SFC Alert*. Questions and comments can be sent to sfcalert@hksfc.org.hk.

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